SUPREME COURT, U. S.

No. 1130

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In the Supreme Court of the United States

OCTOBER TERM, 1967

HUNTINGTON TRUST & SAVINGS BANK,
A CORPORATION, PETITIONER

v.

H. B. AGSTEN & SONS, INC., ROBERT MOOT, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, and ODUS R. KINCAID and DELBERT E. WILLIAMS, TRUSTEES, WILLIAM H. MEINERS, d.b.a. GENERAL FLOOR COMPANY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR SMALL BUSINESS ADMINISTRATOR AND TRUSTEES IN OPPOSITION

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OPINIONS BELOW

The *en banc* opinion of the court of appeals (Pet. App. 44-64) is not yet reported. The district court,

[1] Robert Moot has succeeded Bernard L. Boutin as Administrator of the SBA.

without opinion, adopted the Report of the Special Master (Pet. App. 13-43).

JURISDICTION

The judgment of the court of appeals was entered on December 4, 1967. The petition for certiorari was filed on March 1, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the court below properly determined that, when federal and state statutes provide different orders of priority in case of insolvency, the state priorities should be applied to the distribution of any funds to which the federal priority does not attach.

STATEMENT

This is an insolvency proceeding in which three secured liens more than exhaust the proceeds of a judicial sale. The only disputed question concerns the order of their priority *inter sese*.

In mid-1964, H. B. Agsten & Sons, Inc. (Agsten) began construction of a motel for West Virginia Industries Development Corporation. Prior to that time, West Virginia Industries had obtained an authorization and commitment for a loan from the Small Business Administration (SBA) in the amount of $1,042,500.00. That authorization required West Virginia Industries to obtain a loan of $400,000.00 from a nongovernment lender. Nearly four months after the start of construction, West Virginia Industries ob-

tained a $400,000.00 loan from petitioner which was secured by a deed of trust covering the property involved. Shortly thereafter, the SBA loan was consummated. That loan was secured by a second deed of trust which stated that it was subordinate to the earlier deed of trust held by petitioner.

By the time of the completion of the motel in mid-1965, West Virginia Industries was insolvent. Agsten then filed a notice of mechanic's lien for $217,098.33, and brought this suit to enforce its lien.

All parties agreed that, by virtue of state law, W. Va. Code (Michie Ed.) 38-2-1, 38-2-17, the contractor's lien held by Agsten is superior to the mortgage lien of petitioner; that, by virtue of the respective mortgage instruments, the lien of petitioner is superior to that of the SBA; and that, by virtue of R.S. 3466, 31 U.S.C. 191, the lien of SBA is superior to that of Agsten. The only question in dispute is how to resolve the problem of circuity of priority created by the conflicting federal and state priority statutes.

The special master and the district court determined that the amount of petitioner's lien would be first set aside as prior to that of SBA, but that state law would require that Agsten's lien be satisfied in full out of that amount before the remainder was paid to petitioner. Then the lien of SBA would be satisfied, followed by the remainder of petitioner's lien.[2]

The court of appeals, *en banc*, affimed the district court. The court held that, when a circuity problem

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[2] The sale did not produce enough money to completely satisfy SBA's lien under this theory of distribution.

arises because of conflicting state and federal priorities, the uniform decisions of lower courts and the decision of this Court in *United States* v. *New Britain*, 347 U.S. 81, 87-88, require that federal law first be applied. Federal law, it held, however, required only that, after the payment of the $400,000 to which SBA was subordinated, SBA should be recompensed for its loan to the extent possible. But the ultimate disposition of the $400,000 was held to be purely a matter of state concern. Since state law gave priority to contractors' liens, Agsten would be paid out of that amount before petitioner. Thus, the court found, that disposition "satisfactorily accommodates the competing interests of state and federal law * * *" (Pet. App. 45).

ARGUMENT

The decision below, which is in accord with the decision of this Court in *United States* v. *New Britain*, 347 U.S. 81, 87-88, and the uniform decisions of lower courts, does not warrant further review by this Court.

1. The question here is whether petitioner can somehow take advantage of the priority enjoyed by the United States under federal law in order to exclude the contractor, whose priority over petitioner flows from the provisions of state law.

The priority of the SBA is created by the terms of R.S. 3466, the insolvency statute, 31 U.S.C. 191.[3]

[3] In addition, under Federal law, the lien of SBA would be superior to that of Agsten even if there were no insolvency, since Agsten's lien was not "choate" at the time that of SBA attached, and thus would be inferior thereto under the "first

That statute commands that, if the debtor is insolvent, the debts due the United States "shall be first satisfied". Cf. *United States* v. *Vermont*, 377 U.S. 351. The sole recognized exception to that statute has been for previously executed mortgages, see, *e.g.*, *United States* v. *Texas*, 340 U.S. 480, 484.[4] SBA, in accordance with the recognition of an exception for previously executed mortgages, provided in its deed of trust that it would be subordinate to the lien of petitioner's mortgage.

Petitioner asserts (Pet. 8-10) that since SBA holds a second deed of trust which is expressly subordinate to petitioner's first deed the SBA's priority under R.S. 3466 should be extended to petitioner under the holding in *SBA* v. *McClellan*, 364 U.S. 446. This argument would seem to postulate that SBA's agreement with West Virginia Industries to accept a second

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in time, first in right" doctrine. *United States* v. *Colotta*, 350 U.S. 808; *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010; *United States* v. *Vorreiter*, 355 U.S. 15.

[4] It has been frequently argued that an additional exception exists for specific and perfected liens. This Court, while reserving the question of whether such an additional exception exists, has held that if it did exist, it would apply only when the lien is so "perfected and specific" that title or possession would be viewed as passing to the holder of the lien. See, *e.g.*, *United States* v. *Gilbert Associates*, 345 U.S. 361, 365-366; *United States* v. *Waddill Co.*, 323 U.S. 353, 355; *Illinois* v. *Campbell*, 329 U.S. 362, 370. Petitioner errs in contending (Pet. 6-8) that this case presents the question so far reserved by this Court. Since petitioner's mortgage is already conceded to defeat the R.S. 3466 priority under federal law, the issue of whether petitioner's mortgage lien is sufficiently "specific and perfected" to defeat SBA's R.S. 3466 priority could not possibly enter this case.

mortgage constituted some kind of joint venture arrangement with petitioner, with an agreement to extend the government's priority to petitioner.

However, nothing in *McClellan* supports such a proposition. In that case the SBA had made a joint loan with a private bank—the SBA furnished three-fourths of the funds and the private bank the remainder. After bankruptcy was filed against the borrower, the SBA filed a claim for the full amount due on the loan but asserted its priority only as to three-fourths of the entire amount. In these circumstances, this Court held that the SBA did not forfeit its priority by agreeing to share its recovery with the private bank. However, the Court's decision rested on the fact that the priority was being asserted only as to the amount due the SBA and, therefore, the other creditors had no standing to complain about how SBA chose to dispose of the funds to which it was legally entitled. The situation here is entirely different, for petitioner is contending that the amount of SBA's priority should be increased to include not only the amount loaned by SBA but also the amount of petitioner's mortgage. As the court of appeals noted (Pet. App. 54), there is absolutely no support here for the notion that SBA ever agreed to extend the government's priority to petitioner or that it entered any kind of joint venture.

2. Petitioner also contends (Pet. 12) for a theory which would apply state law first, then federal law. Thus, under West Virginia law, Agsten would come first and petitioner would follow. However, SBA's claim would be given precedence over all claims that

could not withstand the application of R.S. 3466. Thus, petitioner contends that while in theory Agsten would be given first priority under state law, he would not be entitled to any actual payment because SBA's claim, which has priority under federal law, would exhaust all available funds. However, petitioner would be allowed to recover in full because its claim would have priority over that of SBA. Thus, R.S. 3466 would be used to provide petitioner—which, as the court below noted (Pet. 50-52), was the only party which could have completely protected itself from Agsten's lien when making the loan—with a complete priority over Agsten. The Federal Insolvency Statute, however, was not intended to regulate the priorities of non-federal liens *inter sese*, and this theory would destroy the priority policy of West Virginia which accords Agsten priority over petitioner. As the Fourth Circuit properly held, that theory "offends the West Virginia lien statutes * * *; the Federal Insolvency Statute * * *; and our sense of equity * * *" (Pet. App. 51).

In *United States* v. *New Britain*, 347 U.S. 81, 87-88, this Court faced a similar circuity problem arising out of competing state and federal priorities. In *New Britain*, federal liens were, under federal law, superior to certain municipal liens but inferior to mortgage and judgment[5] liens. Under state law, however, the municipal liens were superior to the mortgage and judgment liens. The state court initially

[5] The priority of the United States under the insolvency statute did not apply, since the record did not show insolvency. Id. at 85.

placed the United States last in priority, reasoning that since the federal liens were inferior to the mortgage and judgment liens and the mortgage and judgment liens were inferior to the municipal liens, Congress must have intended the federal liens to be inferior to the municipal liens. *Brown* v. *General Laundry Service*, 139 Conn. 363, 94 A.2d 10, 15. This Court reversed, holding that:

> The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien. * * *

United States v. *New Britain*, 347 U.S. 81, 88. Upon remand, the state court resolved the circuity problems in the same manner as the courts below. *Brown* v. *General Laundry Service*, 19 Conn. Sup. 335, 113 A. 2d 601, 604. Since federal law demands only that the federal liens be satisfied after a sum equal to petitioner's claim is paid out, there is no reason to bar the state from allocating priorities as to liens wholly governed by state law with respect to the sum to which the federal priority does not attach. That is the approach uniformly taken by the lower federal courts. See, *e.g.*, *Exchange Bank & Trust Co.* v. *Tubbs Manufacturing Co.*, 246 F. 2d 141, 144 (C.A. 5); *In re Lieb Bros. Inc.*, 251 F. 2d 305 (C.A. 3); *United States* v. *Lord*, 155 F. Supp. 105, 110 (D. N.H.); *Smith* v. *United States*, 113 F. Supp. 702, 711-712 (D. Haw.). See also *Samms* v. *Chicago Title & Trust Co.*, 349 Ill.

App. 413, 111 N.E. 2d 172, 176-177; *Southern Ohio Sav. Bank & Trust Co.* v. *Bolce*, 165 Ohio St. 201, 135 N.E. 2d 382, 391.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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